NCLR
NATIONAL COUNCIL OF LA RAZA

Laying the Foundation for Improved Access to Credit for Hispanic Families

Presented at:

"Community and Consumer Advocates' Perspectives on the Obama Administration's Financial Regulatory Reform Proposals

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Good morning. My name is Janet Murguía. I am the President and CEO of NCLR (the National Council of La Raza)—the largest national Hispanic[1] civil rights and advocacy organization in the United States. For the last four decades, NCLR has been committed to improving opportunities for the nation's 47 million Latinos. To this end, NCLR conducts research, policy analysis, and advocacy on a variety of financial services issues that impact the ability of Latinos to build and maintain assets and wealth. I would like to thank Chairman Frank and Ranking Member Bachus for inviting me to participate in this timely and important hearing.

NCLR is deeply concerned that a generation of Latino wealth will be lost as a result of widespread failures of the banking systems and insufficient policy responses. Latinos have been historically marginalized from mainstream financial services, such as basic banking and checking accounts. Despite the many barriers, Latinos are entering the financial services market in record numbers. Unfortunately, these same barriers leave Hispanic borrowers vulnerable to abuse. As a leading voice for Latino consumers, NCLR has been warning corporations and governments for years that the financial markets do not serve Latino consumers well. Unprecedented foreclosures on homes and rising household debt from burdensome credit cards and car loans have exposed the system's weaknesses. We and our national network of Affiliates have been doing our part to ensure that potential Latino homeowners have access to safe and affordable credit and home loans, as well as high-quality financial advice. As a housing counseling intermediary, NCLR serves more than 38,000 homebuyers and homeowners every year. The NCLR Homeownership Network (NHN) has expanded beyond its traditional work in homeownership counseling to include foreclosure prevention, rental assistance, and financial planning. We understand what it takes to build sustainable wealth in Latino communities and have executed a successful strategy to do so.

Our national banking system is failing communities of color. Latino families are routinely steered toward inferior financial products designed to profit front-end originators, often resulting in default or burdensome debt. In contrast, a well-functioning system would put families on a path to financial security, building wealth for future generations. We applaud the administration and Congress, especially members of this committee, for taking on a bold regulatory reform agenda. We urge Congress and regulators to move swiftly to create a regulatory environment that promotes financial security for all communities, rather than quick profits for a few.

In my testimony today, I will discuss critical weaknesses in our banking system that have led to a two-tier financial system in which communities of color and other underserved populations routinely pay more for financial services and credit. I will also offer our analysis on the ways in which the administration's proposed overhaul addresses our concerns. I will close with a series of recommendations on how the proposed reforms can be strengthened.

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[1] The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, Spanish, and other Hispanic descent; they may be of any race.

Banking System Shortfalls

All Americans rely on financial products to help them buy homes and otherwise build wealth and financial security. Access to safe and affordable credit is an important means to this end for Latinos as they more fully integrate into the mainstream financial system and work to gain access to the American middle class. Yet, clear disparities exist between the quantity and quality of credit and banking products made available to low-income and minority consumers. These disparities perpetuate the wealth gap between minority and White households. Our banking oversight and regulatory systems are outdated, leaving consumers, investors, and even banking institutions themselves vulnerable to the consequences of failure. Congress must take this opportunity to modernize our banking oversight infrastructure with the goal of improving the quality and quantity of credit available to marginalized communities while also protecting consumers and investors.

Hispanic families are entering financial markets at a rapid rate, demonstrating a clear and growing demand for services. With their purchasing power to exceed 1.2 trillion by 2012,[2] it is no wonder that many financial institutions are looking for ways to capture the Hispanic market. However, the industry has taken few steps to develop or tailor products that meet their needs. Predatory lenders have been quick to fill the gaps between the needs and demands of consumers and the offerings available at banks and credit options. As a result, families waste hard-earned income on fees and high interest rates, rather than saving or paying down principal, and are at high risk for burdensome debt, foreclosure, and bankruptcy. There are numerous examples:

- **Lending:** Hispanic mortgage borrowers are more likely to have nontraditional profiles, resulting in rejection by automated underwriting. Even though the technology and business models exist to serve such a profile, originators often choose the more profitable route of steering families into subprime and exotic loans, even when their credit and income justify a prime product. As a result, Latino borrowers are more than twice as likely to receive a subprime home loan and are overrepresented among interest-only and negatively amortizing products.[3] In the case of auto lending, research has shown that Latino borrowers are more likely than White borrowers to receive an unnecessary markup in their interest rate, and the markup is typically higher for Latinos than Whites.[4]

- **Credit:** Hispanic families are less likely than others to have a credit card. Selective marketing tactics ensure that they only receive offers from the most expensive cards, which are characterized by terms and conditions that pile on fees and interest rate hikes. Latinos are nearly twice as likely as Whites to have a credit card interest rate over 20%.[5]

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[2] "Hispanics Are the Largest Minority in the U.S. with Purchasing Power Projected to Exceed...," *Reuters.com*, March 31, 2008, http://www.reuters.com/article/pressRelease/idUS124765+31-Mar-2008+BW20080331 (accessed January 9, 2009).

[3] Robert B. Avery, Kenneth P. Brevoort, and Glen Canner, "The 2007 HMDA Data," *Federal Reserve Bulletin* 94 (December 23, 2008).

[4] Mark A. Cohen, "Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation," Vanderbilt Law and Economics Research Paper no. 07-01 (December 14, 2006).

[5] Jennifer Wheary and Tamara Draut, *Who Pays? The Winners and Losers of Credit Card Deregulation* (New York, NY: Demos, 2007).

- **Banking:** Nearly one in six Latinos does not have a basic bank account. Two of the most commonly cited reasons for not having a transaction account by all those without one is that they do not like dealing with banks or the service fees are too high. When traditional banks do not meet their needs, consumers are driven to fringe financial providers that often charge high fees and do not encourage long-term savings.[6]

There is overwhelming evidence demonstrating that minority borrowers pay more to access credit than similarly situated White borrowers. This pattern of overpayment, abuse, and discrimination disrupts the financial stability of low-income and minority communities, and impedes their movement toward the middle class. There are four fundamental issues that characterize how the banking and financial services markets drain wealth rather than build it.

- **Shopping for credit is nearly impossible.** Many credit offers are not transparent. Credit card, auto loan, and mortgage borrowers are often unaware of the hidden costs included in their loans. Few shopping tools exist that can help borrowers create true apples-to-apples cost comparisons. As a result, some borrowers forgo shopping altogether while others rely on intermediaries, such as mortgage brokers or auto dealers, to shop on their behalf. Numerous studies and reports showing deception and hidden costs through these delivery channels demonstrate that brokers and dealers cannot be trusted consistently to operate in a manner that truly benefits the borrower. Furthermore, issuers of credit aggressively shop for their borrowers by trolling credit profiles and sending offers to their selected profile. This system guarantees opportunities for some and makes easy targets for high-cost products out of others.

- **Borrowers are steered toward expensive products regardless of creditworthiness.** Many low-income and minority borrowers have unique borrower profiles—such as thin credit files, multiple co-borrowers, or multiple sources of income—that are not easily processed through automated underwriting. Rather than taking the time to match these consumers with existing products that accurately measure their true risk, lenders err on the side of higher-risk and steer borrowers toward products that are easier to originate and highly profitable. Low-income and minority borrowers are more likely than similarly situated White borrowers to receive high-cost mortgage loans, even after controlling for income, co-applicant, and credit. The scenario is the same for credit cards and auto loans—Hispanic and African American borrowers are more likely than their White peers to get higher markups or pay higher interest rates. In fact, in auto and mortgage lending, brokers and dealers are paid kickbacks (known as Yield Spread Premiums in mortgage loans) for putting consumers in loans with higher interest rates than their credit warrants.

- **Creditors trap borrowers in cycles of debt.** For some subprime borrowers, excessive fees, high interest rates, and mounting debt effectively trap them in the subprime market. For example, many credit card customers find relief from a high interest rate card by transferring their balance to a credit card with a lower interest rate. Transferring balances from one card to another is not an option for consumers who carry high interest rates and

[6] Brian K. Bucks, Arthur B. Kennickell, Traci L. Mach, and Kevin B. Moore, "Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin* 95 (February 12, 2009).

who are often rejected for credit. In the case of home loans, the pervasive use of loose underwriting criteria led to the origination of loans that homeowners could never afford to repay. The mortgage industry wagers that the value of home prices would continue to climb and clients would refinance if their mortgage product became too expensive. This practice led many families into a downward spiral of wealth-draining refinances that has contributed heavily to the current mortgage crisis.

- **Fraud and scams are rampant.** Compounding the impact of predatory lending and the gaps in consumer protections is the rise of fraud and scams targeting victims of burdensome debt and foreclosure. Research conducted by the Federal Trade Commission (FTC) shows that 14.3% of Hispanics are victims of fraud, compared to 6.4% of non-Hispanic Whites.[7] From fake credit cards claiming to help families build credit to foreclosure rescue scams claiming to help families save their home, fraud is on the rise. In fact, scammers are taking advantage of the industry's slow response to the administration's Making Home Affordable program by marketing quick access to loan modifications. Families are paying thousands of dollars in desperate attempts to reach their servicer and save their home.

Examining Proposed Reform

NCLR applauds the bold reforms proposed by the Obama administration. The market's breakdown in its service to communities of color, low-income families, the elderly, and other traditionally underserved populations has had a devastating impact that extends well beyond those initially harmed. Though we have not taken formal positions on every aspect of the proposed reforms, NCLR is actively engaged in Americans for Financial Reform (AFR), which has established positions on each segment of the administration's proposal.[8] In addition to offering general support, there are four areas of the proposed reforms that are of particular importance to communities of color and must be maintained as the proposal moves through the legislative process:

- **Housing the missions of promoting access to credit and protecting borrowers in the same regulatory agency.** In some cases, the failure of banks to serve the community has gone beyond poor service to include active disengagement from certain communities or populations and discrimination. In the meantime, some community banks, credit unions, and Community Development Financial Institutions (CDFIs) offer safe and fair credit and banking products, but are often beat in the marketplace by bigger banks or predators with large marketing budgets. For these reasons, we see the value of an independent agency to evaluate, test, and track the performance of financial products. Such evaluations must be conducted in light of the credit needs of diverse communities. Communities of color have long been cut off from mainstream banking institutions, often because banks do not offer products that meet their needs and borrower profiles. The proposed Consumer Financial Protection Agency (CFPA) would place value on promoting positive innovations in the market and limitations on new practices and products that would drain wealth and increase debt.

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[7] "Consumer Fraud in the United States: An FTC Survey," Federal Trade Commission Staff Report (August 2004).
[8] For more information, visit Americans for Financial Reform at http://ourfinancialsecurity.org.

- **Holding all players in the market accountable.** Players throughout the banking system, from originators, brokers, and credit issuers to Wall Street investment firms, had a hand in manipulating a weak regulatory system to maximize short-term profit gains, leading to our current foreclosure crisis. Mortgage brokers earned profits at the closing table with no investment in the long-term performance of a home loan. Banks and mortgage finance companies routinely packaged and sold their loans within hours of the transaction. Investment firms heavily influenced the terms and types of credit cards, car loans, and mortgages available for consumers by establishing risk tolerances and directing capital to certain products. The proposed reforms would hold all of these players accountable for their role in extending credit by requiring banks to retain a portion of the credit risk on loans they originate and closing loopholes that allowed some finance companies and bank affiliates to evade compliance with more prudent state and federal laws.

- **Emphasizing simple, straightforward banking and credit products.** All too often, standard, safe mortgage and credit products were beat in the marketplace by those that were high risk and, thus, highly profitable. Compensation schemes guaranteed that brokers, originators, and card issuers would put forward their most expensive products first, wherever possible, and seek to further maximize profit by attaching expensive add-ons and kickbacks, such as Yield Spread Premiums. These compensation structures are at the root of predatory lending and steering. The Obama proposal promotes the creation and advancement of straightforward financial products that emphasize consumer safety and affordability, such as a classic 30-year fixed rate mortgage and automatic enrollment in employer-sponsored retirement accounts. NCLR encourages Congress to take this concept a step further by making the offering of such products the default option for originators before moving to more expensive and risky products.

- **Making enforcement a priority.** Much of the current foreclosure and household debt problem is attributable to gaps in consumer protections and an unwillingness to enforce current law. For example, despite widespread evidence of racial and ethnic steering and other violations of civil rights laws, bank regulatory agencies refused to take enforcement action against lenders. Individual borrowers struggled to make their case against brokers or financial institutions when their rights were violated. Legal resources for modest-income families are scarce and consumer complaints often go without a response. The administration's proposed reforms put an emphasis on enforcement by creating a meaningful system for analyzing consumer complaints, protecting private rights of action, and creating new tools for regulators to assess systemic risk.

It should also be noted that the concepts of promoting greater access to the financial mainstream and increasing protections for vulnerable consumers are not in conflict, though at times a healthy tension may exist. Financial industry lobbyists often attempt to paint commonsense regulation as cutting off access to credit for minority families. This is a false argument and a scare tactic. Throughout the country, credit unions, community banks, and nonprofit lenders are serving the community well by creating alternatives to payday loans, offering free checking accounts, and using nontraditional credit information to underwrite loans. They do it while holding to the highest standards of safety and soundness, and generally offer prime pricing. NCLR strongly urges Congress and the CFPA to look to market leaders for innovative ways to expand all forms of credit and banking products to underserved communities, without sacrificing consumer protections.

Recommendations

NCLR welcomes the bold vision of the administration and many others who have contributed to the ideas and concepts within the proposal. Our current regulatory system has not kept pace with our expanding and dynamic financial markets. We need a regulatory system that is nimble and strong, and can respond to the complex demands of a global market as well as the individual circumstances of the consumers who make up one of their fundamental constituencies. In that spirit, we offer three recommendations for further strengthening the proposal.

- **Create an Office of Fair Lending Compliance and Enforcement within the CFPA.** Civil rights must be prioritized as a part of the agency's formal structure by establishing an office dedicated to promoting and enforcing fair housing and lending laws. This office should ensure that the CFPA itself operates in a manner that affirmatively furthers fair housing and that financial market players comply with fair lending statutes. It must have sufficient authority and resources to conduct fair lending examinations, engage in compliance activities, and write rules, and should be headed by a senior position who reports directly to the director of the CFPA.

- **Help consumers make smarter financial decisions.** The administration rightly proposes that the CFPA streamline disclosures and create standards that will simplify consumer shopping. However, these reforms stop short of improving borrowers' decision-making options. To achieve this, NCLR recommends that Congress go beyond general financial literacy and create a federally funded financial counseling program. Under such a program, nonprofits could provide objective, tailored advice to modest-income families to help them manage their personal finances, build credit, avoid unmanageable debt, plan for retirement, and spot scams.[9] In fact, this is the mainstream approach taken by families with the means to do so—they seek the advice of a professional financial planner or investment advisor. The CFPA can help give this same opportunity to lower-income families.

- **Improve data collection.** Publicly available data, such as those available under the Home Mortgage Disclosure Act (HMDA), have been valuable tools for holding financial institutions accountable. The administration's plan is unclear on the extent to which it would increase data collection and make data publicly available. NCLR recommends that data be collected, and publicly disseminated, on small business lending, credit cards, auto loans, and insurance products.

Conclusion

Communities of color have clearly been targeted by lenders for inferior products, even when they have high incomes and good credit. Hispanic borrowers continue to face real barriers to

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[9] For a longer discussion on the creation of a community-based financial counseling program see House Committee on Financial Services Subcommittee on Financial Institutions, *Empowering Latino Consumers Through Financial Counseling*, 111th Cong., 1 sess., 2009.

accessing safe, fair, and affordable credit. Most of these families will not be able to move firmly into the middle class and achieve financial sustainability without access to credit and safe banking products. We need a strong regulatory system that will promote a well-functioning marketplace that allows borrowers fair and equal access to the banking system throughout their lifecycle. We look forward to working with Congress and the administration toward this end.